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October 12, 2005

Mr. Charles Terreni
Chief Clerk/Administrator
South Carolina Public Service Commission
101 Executive Drive
Columbia, SC 29210

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SC PUBLIC SERVICE
COMMISSION

RE: Docket No. 2005-191-E

Dear Mr. Terreni:

Enclosed for filing with the Commission in the above docket are the original and twenty-five (25) copies of Progress Energy Carolinas, Inc.'s Rebuttal Testimony for Samuel S. Waters. PEC also supports the rebuttal testimony of Dr. Julius Wright submitted on behalf of South Carolina Electric & Gas Company.

Sincerely,

Len S. Anthony
Deputy General Counsel-Regulatory Affairs

LSA:mhm

Enclosures

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OK D. Duke

PROGRESS ENERGY CAROLINAS, INC.

DOCKET NO. 2005-191-E

REBUTTAL TESTIMONY OF

SAMUEL S. WATERS

1 **Q. Please state your name, employer, and business address.**

2 **A.** My name is Samuel S. Waters and I am employed by Carolina Power & Light Company,
3 d/b/a Progress Energy Carolinas, Inc. (PEC). My business address is 410 S. Wilmington
4 Street, Raleigh, North Carolina, 27602.

5 **Q. Have you previously submitted testimony in this docket?**

6 **A.** Yes, I have.

7 **Q. What is the purpose of your rebuttal testimony?**

8 **A.** I wish to address some of the key issues raised by Messrs. Eves and Dismukes on behalf
9 of NewSouth Energy, LLC, (a division of Calpine) and Mr. Willick on behalf of LS
10 Power Development, LLC in their direct testimony. Specifically, I would like to address
11 the following:

- 12 – whether requiring an RFP process in all resource decisions is necessary or
13 appropriate.
- 14 – whether a collaborative process is needed to develop the RFP or evaluate bids.
- 15 – whether a pre-defined scoring system or standardized criteria are needed in
16 evaluating the bids received in response to an RFP.
- 17 – whether independent 4th party oversight should be required in conducting an RFP
18 and/or evaluating the bids received.

1 In addition to these issues, I will also comment on existing RFP practices that have been
2 put forward as good examples, based on my own experience with issuing RFPs and
3 evaluating the responses particularly in Florida, as well as negotiating and administering
4 contracts for purchased power.

5 **Q. Dr. Dismukes recommends that all discretion be taken from the electric utilities of**
6 **South Carolina with regard to the use of RFPs and that utilities be required to use**
7 **RFPs (designed by a committee) before acquiring any new resource. Do you agree**
8 **with this recommendation?**

9 **A.** No I do not for several reasons. First, I provided several examples in my direct testimony
10 of situations where bidding might be inappropriate or even harmful to customers. For
11 instance, in cases where system reliability must be maintained, or where unique market
12 opportunities present themselves, a utility must have the discretion in making resource
13 addition decisions.

14 Secondly, it must be remembered that PEC and the other utilities providing
15 electric service in South Carolina have been in the electric utility business for several
16 decades. We have fulfilled our obligation to plan for and to serve South Carolinians well
17 with reliable power at affordable rates. We are constantly studying, tracking and
18 evaluating the costs of new generation and the market price for purchased power. We
19 know what it costs to build a combustion turbine (CT) or a combined cycle facility (CC).
20 We know what power is selling for in the forward markets. When seeking to build new
21 CTs and CCs we request bids from the equipment manufacturers. When seeking to build
22 new baseload generation we request proposals from the contractors capable of
23 constructing such plants. We do not always need to issue an RFP to know who may be in

1 a position to provide the resource we need or the price of the resource we need. Thus, in
2 many situations, issuing an RFP is simply a waste of our customers' money.

3 It must be emphasized that in short term resource acquisition situations RFPs are
4 simply not practical. There simply is not time to perform an RFP before making hourly,
5 daily, weekly and monthly purchases. While I am not entirely clear as to Dr. Dismukes'
6 position on this matter he seems to be suggesting that bidding processes should be used
7 for even short-term purchases. I think even Dr. Dismukes would agree that the use of
8 formal RFPs for such purchases is not feasible. But more importantly, given that PEC,
9 Duke and SCE&G all dispatch the resources available to them in the most cost-effective
10 manner possible, constrained only by reliability considerations, even if there were time to
11 perform an RFP it would provide no value. The utilities of South Carolina all engage in
12 security constrained economic dispatch. This means when we are determining the
13 resources we will use the next day to meet forecasted system load, we consider the
14 reliability and cost of every single resource available to us, whether utility-owned or not.
15 We then use those resources that are the least expensive to operate to meet our
16 customers' needs. If a reliable non-utility resource is available that is less expensive than
17 company-owned generation, we use it.

18 The question before this Commission then becomes: who should be responsible
19 for the selection of the resources relied upon by a utility to meet the needs of its retail
20 customers. Is it the utility that has the statutory obligation to plan for and serve all
21 customers in its control area? Is it the Commission? Or is it some fourth party (I will
22 explain shortly why I refer to the independent entity recommended by Calpine and LS
23 Power as a "fourth party"), over whom the Commission has no jurisdiction. Given that

1 the “buck stops” with the utility when it comes to keeping the lights on, the answer has to
2 be the utility.

3 The fact is, all resource decisions require some amount of judgment and
4 expertise, and no single standard can be applied as to how those decisions be made.
5 Ultimately, each and every decision that a utility makes regarding its capacity resources
6 will be subject to review by the Commission, and it is the utility that is responsible for
7 ensuring that the Commission has adequate information to pass judgment on the
8 transactions. Checks and balances are in place and customers are already protected. No
9 additional levels of control are needed.

10 **Q. What has been suggested regarding a collaborative development of an RFP or**
11 **evaluation of bids received?**

12 **A.** Mr. Eves has cherry-picked the attributes of various state processes that he likes best,
13 offering as examples:

14 “Several of the characteristics of other processes that work well include: i)
15 issuance of a draft RFP and an opportunity for all participants to comment on and
16 receive clarification on select areas before the final RFP is issued (GA); ii) the
17 opportunity to raise issues to the Commission for resolution prior to the issuance
18 of the final RFP (FL).....” (Eves, page 9, lines 9-13)

19 Mr. Willick is more explicit:

20 “Bid evaluation rules should be determined through a collaborative process of
21 interested stakeholders, including market participants, commission staff and the
22 utility.” (Willick, page 6, lines 12-14)

1 **Q. Do you believe that these suggestions are beneficial or necessary?**

2 **A.** I do not. Only one of the “interested stakeholders” that Mr. Willick refers to is
3 accountable for the outcome of the RFP. Only one of those stakeholders is accountable
4 for the provision of reliable and cost effective electricity supply to customers. And only
5 one of those stakeholders will be judged on the prudence of the final outcome, both at the
6 time the decision is made, and in hindsight. That stakeholder is the utility making the
7 capacity decision. The utility is obligated to act in the best interest of its customers, and
8 an RFP may be the best way of doing that, or there may be other ways of best meeting
9 customer needs. I note that the only qualification that Mr. Willick requires for inclusion
10 in the RFP development is that someone be “interested,” not affected or accountable.
11 Maybe more tellingly, he does not suggest that customers be represented. If, as would
12 seem reasonable, representation by the utility is assumed to also mean representation of
13 customers, then no further representation is needed, since only the customers interest
14 should be of importance.

15 By attempting to control the terms and conditions of the RFP, LS Power and
16 Calpine are again attempting to take away the discretion of the utility (and the
17 Commission), and grant to a fourth party control of the design of the RFP and the
18 administration of the RFP, effectively giving this fourth party the ability to pick the
19 resources to serve the utility’s customers, with no real accountability. The utilities are the
20 ones with the responsibility of ensuring a reliable and adequate supply of electricity, and
21 the ones held accountable by the Commission and the General Assembly. If another
22 party is given the power to select the resources, then that fourth party needs to be subject

1 to the jurisdiction of this Commission and the utilities should be relieved of
2 accountability for those resource selection decisions.

3 Regarding Mr. Eves' suggestions, I can only say that in conducting RFPs, PEC
4 has followed principles related to good business practice, holding pre-bid conferences,
5 responding to questions, and creating web sites for the public exchange of information, as
6 appropriate to a particular RFP and the timing required for decisions.

7 **Q. Do you have any other concerns with a collaborative process to design an RFP?**

8 **A.** Yes. The first obvious concern is that I do not believe that it can be accomplished and
9 meet Dr. Dismukes' criterion of "Expeditious yet deliberate" (Dismukes page 34, line
10 19). An RFP process now takes 6 months or more to complete, and a design by
11 consensus will add more time to that process. I am also concerned that the focus would
12 drift towards some parties obtaining commercial advantage, rather than meeting
13 customers' needs, and that the final product would be ineffective in making a final
14 determination that fully addresses the long-term issues that the utility will have to face,
15 including system operating conditions and regulatory objectives. In simpler terms, I am
16 reminded of the expression that a camel is a horse designed by committee.

17 **Q. Should standardized scoring criteria or a standardized evaluation process be**
18 **considered in an RFP rule?**

19 **A.** Absolutely not. I have had experience with attempts to pre-define a scoring system and a
20 rigid process to select a bid for new capacity. In particular my experience was in Florida,
21 a State Dr. Dismukes holds up as an example this Commission should follow in this
22 regard. The real difficulty with this approach, as with most quantitative methods, is that
23 the scoring system itself must be established without a full understanding of the way in

1 which any particular component can affect the outcome. This might be offered as an
2 example of “fairness” by some, but let me clarify by example. Consider an RFP where it
3 has been determined that 50% of the score will be determined by economic ranking, and
4 50% by “qualitative” factors, such as the financial health of the bidder, dispatchability or
5 level of control offered by the facility, environmental characteristics, diversity offered by
6 the fuel source, etc. Obviously, there are some minimum requirements to be met, but for
7 the sake of the example, I will assume that all bidders meet those minimum requirements.

8 Assume that Bidder A offers the most economic project, and is awarded 50 points
9 out of 50 in the scoring. Bidder B, which has the next most economic project, is awarded
10 49 points, but this project provides less savings overall and is much more expensive in
11 the first years of operation. The qualitative evaluation shows Bidder B to be better than
12 Bidder A by 2 points, although neither ranks at the top of the qualitative evaluation.
13 Both are marginally acceptable on the financial health scale. Based on my pre-defined
14 scoring, I should select Bidder B, but because that project is more expensive in the early
15 years, the savings to customers might ultimately be at more risk. Should I be required to
16 select Bidder B as the winner? Some might suggest that I can simply think through these
17 issues before I define the scoring, but I would suggest that it is not possible or practical to
18 try and identify every single factor that might affect the outcome. This does not make the
19 outcome arbitrary. It simply recognizes that judgment is required in selecting between
20 similar alternatives, and it is the party that is accountable for the outcome, and the long-
21 term consequences, that should retain the right to exercise that judgment

22 Consider another example, using the same two bidders above, where Bidder A is
23 much more economic than Bidder B, but Bidder B has a much higher financial rating, as

1 measured by bond ratings for instance, than Bidder A. Assume that in all other aspects,
2 the bids are relatively similar, but the scoring for economics and financial health result in
3 Bidder A being slightly better. If the scoring is predefined, and I am allowed no
4 discretion in choosing between the two projects, I must select Bidder A, despite the
5 higher risk represented by the financial rating. While the intervenors suggest that
6 customers are insulated from risks by purchasing power rather than buying, I would
7 suggest that this is not the case at all. In fact, in this instance, I would be forced to buy
8 from a supplier that may not remain financially viable for the full length of the contract.
9 The ultimate risk to customers is presented by the ability of an independent power
10 supplier to walk away from a non-profitable contract, an option which is not available to
11 the utility required to provide reliable service.

12 **Q. This leads to the next concern as to whether or not an independent 4th party**
13 **evaluator should be used to determine the results of the RFP process.**

14 **A.** This might be a reasonable suggestion if we did not already have an independent third
15 party reviewing the utility's actions. Actually, we have two: the Commission; and the
16 Office of Regulatory Staff ("ORS"). The ORS is charged with investigating a utility's
17 resource acquisition selections and presenting its findings in the certification proceeding
18 before this Commission. The Commission, as the judicial body charged with ruling upon
19 a utility's request to build a generator, must consider all of the evidence presented by the
20 ORS, the utility and any other parties in making its decision. The same is true when the
21 utility seeks cost recovery of the resource in question. A suggestion that a fourth party
22 should be inserted into this process is an implicit suggestion that either the ORS, the
23 Commission, or both are not doing their jobs.

1 To speak plainly, if it is going to be argued that a fourth party is needed to
2 increase confidence in the resource selection process used in South Carolina, this can
3 only mean that: 1) that the utilities will intentionally skew the analysis in favor of a self-
4 build option; 2) the utilities will hide the truth from the Commission; and 3) the
5 Commission and ORS are not capable of doing their jobs. Let's be clear, the suggestions
6 made by LS Power and Calpine are criticisms not just of the utilities but also of the
7 Commission and the process adopted by the General Assembly regarding utility resource
8 selection. Finally, it bears noting that South Carolina's siting laws dictate that numerous
9 State agencies, counties and municipalities be given notice of an application to build a
10 generator so they can intervene and present their views, thus, providing another level of
11 analysis of the utilities' proposals.

12 **Q. Dr. Dismukes alleges there is some type of conflict of interest by having a utility**
13 **seeking a new resource evaluate the resource alternatives available to it, claiming**
14 **that this is akin to "the proverbial fox watching the hen-house." (Dismukes, page**
15 **43, lines 16-17) How do you address that issue?**

16 **A.** That is an interesting analogy coming from an entity that is seeking to participate in the
17 development of the very RFP that it wishes to bid upon, is attempting to use the
18 regulatory process to force South Carolina utilities to turn over to a fourth party the
19 decision as to whether to purchase from it, and create a regulatory forum to complain
20 when a South Carolina utility decides not to purchase from it. It is also extraordinarily
21 surprising coming from a generator that owns a facility that was bid into an RFP
22 conducted by PEC, that did not use an independent fourth party, and was selected by PEC
23 for a long-term purchase power contract. I find it interesting that neither Calpine witness

1 mentioned in their testimony that PEC is currently buying power from Calpine's Broad
2 River facility under a long-term contract that was the result of an RFP PEC issued
3 voluntarily and without the use of a fourth party. They also did not mention that PEC
4 just completed an RFP for new resources to serve its Asheville area and no one submitted
5 a bid.

6 Putting aside the self interest and bias of Calpine and LS Power, additional
7 evidence that there is no conflict of interest is the past actions we have taken in the
8 evaluation of RFPs. History belies any assertion that utilities have acted inappropriately.

9 No one has suggested that the fox has eaten any chickens to this point, and to continue
10 with the analogy, the utility is more in the role of the farmer tending the chickens so that
11 he can sell eggs to the market. The question is where do we get the eggs? From
12 independent suppliers or raise our own chickens? We have proven, most recently by
13 entering into a long-term contract with Calpine, that we get our "eggs" from the lowest
14 cost reliable source. The resources that PEC currently relies on include a mix of owned
15 and purchased facilities. As shown in the June 2005 filing with the Commission, with a
16 total system capacity of approximately 14,000 MW, PEC is buying more than 1,500 MW,
17 or more than 10% of total capacity needs, from a combination of independent power
18 producers, cogeneration and qualifying facilities, and other utilities. When viewed as a
19 percentage of new resources added over the last ten years, the percentage represented by
20 purchases is even higher. This clearly does not square with Mr. Willick's statement that
21 "Without such rules (i.e. competitive bidding rules), South Carolina ratepayers in a given
22 service area will be relying solely on the incumbent utility for new supply resources."

23 (Willick, page 2, lines 13-15.)

1 **Q. Do we have a problem with the current resource planning and selection process in**
2 **South Carolina? Is the current process broken?**

3 **A.** No, there is no problem and the process is not broken; rather, it has worked to the benefit
4 of South Carolinians. The utilities, using the tools and flexibility available to them, have
5 a long history of providing an adequate and reliable source of electricity to South
6 Carolinians at low rates. South Carolina, like several other southeastern states,
7 recognizes the specific characteristics and importance of utility services that are best
8 provided under a system of regulation by the State. The General Assembly has
9 considered this regulatory structure and declined to implement changes. The foundation
10 of this regulatory framework is that utilities are responsible for providing adequate and
11 reliable power at the lowest reasonable cost to consumers. Under that system, utilities
12 are allowed the freedom and are expected to manage their business to meet their
13 obligations. Dr. Dismukes' proposal would hamper the ability of the utilities to make
14 those decisions for which they alone are accountable. There is no reason to take that
15 drastic step because there is no evidence of a problem.

16 **Q. Please summarize your comments regarding the testimonies offered by Messrs.**
17 **Eves, Dismukes and Willick?**

18 **A.** The recommendations they have made for implementation of a bidding rule and the
19 specific form of the rule should be viewed for what they are, a solution in search of a
20 problem. More precisely, it is a seller trying to obtain an advantage in a market. There
21 has been no suggestion that any utility has acted improperly in making capacity decisions
22 in the past, only an implication that utilities **might** act improperly in the future if not
23 constrained by a detailed rule. There has been no evidence produced that the

1 Commission has not done its job, even though Dr. Dismukes suggests that it has not.
2 This is not a sufficient reason to initiate a rulemaking, or even consider rules that might
3 actually result in harm to customers, and cannot be shown to generate any benefits
4 beyond those already obtained by the current system. Utilities must be able to use
5 discretion in making capacity decisions, because they are accountable for those decisions
6 and the customer service that results from those decisions. RFPs will remain a tool that
7 is used to make capacity decisions when appropriate, and I would expect that RFP's will
8 be issued for most future capacity decisions, but there may be instances where going
9 through a formal RFP process is not in the best interest of customers, and there should be
10 enough flexibility in the acquisition process to recognize that fact.

11 **Q. Does this conclude your rebuttal testimony?**

12 **A.** Yes.

**STATE OF SOUTH CAROLINA
BEFORE THE PUBLIC SERVICE COMMISSION**

DOCKET NO. 2005-191-E

In the Matter of:

Generic Proceeding to Explore a)	
Formal Request for Proposal For)	
Utilities That Are Considering)	
Alternatives for Adding Generating)	CERTIFICATE OF SERVICE
Capacity)	

I, Len S. Anthony, hereby certify that Carolina Power & Light Company d/b/a Progress Energy Carolinas, Inc.'s (PEC) Rebuttal Testimony of Samuel S. Waters has been served on all parties of record either by hand delivery or by depositing said copy in the United States mail, postage prepaid, addressed as follows this the 12th day of October, 2005:

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A handwritten signature in dark ink, appearing to read "Len S. Anthony", written over a horizontal line.

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